

General Information Letter: Unless a specific addition or subtraction modification requires otherwise, amounts excluded from federal taxable income of a corporate taxpayer as the result of an IRC Section 338 election are similarly excluded from base income, and amounts included in federal taxable income as the result of the election are included in base income.

February 13, 2001

Dear:

This is in response to your letter dated January 30, 2001, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us).

In your letter you have stated the following:

We respectfully request an information letter reaffirming the Department's position that an actual distribution of assets by a subsidiary corporation to its parent in a transaction for which an election has been made under Section 338(h)(10) of the Internal Revenue Code ("IRC") will be treated as part of a complete liquidation of the subsidiary into its parent, consistent with the federal income tax treatment.

I. Statement of Facts

Parent ("Seller"), a company incorporated in Delaware, owns 100 percent of the stock of xxxxxx, a New York corporation. Seller proposes to sell 100 percent of xxxxxxxx stock to Buyer, an unrelated corporation. xxxxxx owns certain assets that Buyer is not interested in acquiring (collectively, the "Unwanted Assets"). Therefore, in connection with the Transaction, Buyer and Seller agree that xxxxxx will distribute the Unwanted Assets to Seller. Buyer will purchase the stock of xxxxxx and Seller and Buyer will join in an election pursuant to IRC Section 338(h)(10), whereby the transaction will be treated for federal income tax purposes as if xxxxxx had sold its assets to Buyer and distributed the sale proceeds to Seller in complete liquidation.

II. Relevant Law

The effect of a Section 338(h)(10) election for federal income tax purposes is that the xxxxxxxxxxxxxxxxxxxx is deemed to have sold its assets and distributed the sale proceeds to its shareholder in complete liquidation. See Temp. Treas. Reg. Sections 1.338(h)(10)-1T(d)(3), (5)(i). Gain or loss on the actual sale of the xxxxxxxxxxxxxxxxxxxx stock by a member of the selling group to a member of the purchasing group included in a qualified stock purchase is ignored. See Temp. Treas. Reg. Section 1.338(h)(10)-1T(d)(5)(iii).

When a Section 338(h)(10) election is made, the distribution of unwanted assets by a xxxxxx subsidiary to its parent in connection with the sale by the parent corporation of

all of the xxxxxx subsidiary stock to a third party is considered for federal income tax purposes to be a part of the complete liquidation of the subsidiary as hypothesized by Section 338(h)(10) and not to be a current distribution under IRC Section 301. See Temp. Treas. Reg. Section 1.338(h)(10)-1T(e) Example (2). The xxxxxxxxxxxxxxxxxxxxxxx actual transfer of assets to its parent is treated as a distribution pursuant to a formal plan of complete liquidation where the following conditions are satisfied: 1) the distribution is made pursuant to a formal plan of liquidation (that includes the "deemed" liquidation assumed by Section 338(h)(10)) that is adopted before the stock sale and the distribution, 2) the buyer is obligated to purchase the xxxxxxxxxxxxxxxxxxxxxxx stock at about the same time as the distribution of the unwanted assets, and 3) the buyer and seller have agreed to jointly make a Section 338(h)(10) election. See id.; Temp. Treas. Reg. Section 1.338(h)(10)-1T(d)(4).

Illinois follows the federal treatment of Section 338(h)(10) elections. For example, the Department of Revenue ruled that the only Illinois modification of the Section 338(h)(10) election is the requirement that the selling group included in a federal consolidated return also be included in the Illinois combined return. See Priv. Ltr. Rul. IT 89-306 (Dec. 14, 1989). Accordingly, as long as the seller and subsidiary xxxxxx xxxxxxxxxxxxxxx are included in an Illinois combined income tax return, the parent corporation will not recognize gain or loss on the sale of the xxxxxxxx stock for Illinois income tax purposes.

Likewise, the Department has ruled that a distribution of assets that is an integral part of a transaction for which a Section 338(h)(10) election has been made should be characterized for Illinois income tax purposes as a distribution in complete liquidation. See Priv. Lt. Rul. IT 94-0012 (Mar. 9, 1994). As the Department explained, this result follows from the "legal rationale underpinning Illinois' prior acceptance of the Section 338(h)(10) concept." Id. Since Illinois base income is equal to federal taxable income subject only to certain enumerated modifications, the Department found that it is customary for Illinois to follow federal guidelines in matters of this kind. Thus, if all federal prerequisites are met, Illinois will accord a transaction the same treatment for Illinois income tax purposes.

The facts in the proposed transaction will satisfy all of the requirements for a Section 338(h)(10) election. A formal plan of liquidation by xxxxxx will be adopted; such adoption will occur before the distribution; and Buyer will be required to purchase the stock of xxxxxx. Furthermore, the distribution of Unwanted Assets will be made in connection with the Section 338(h)(10) transaction. Having satisfied all of the necessary requirements for federal tax purposes, it is respectfully submitted that the distribution of Unwanted Assets in the Transaction by xxxxxx to Seller should be treated as part of xxxxxxxx complete liquidation for purposes of the Illinois corporate income tax.

## **Response**

Section 203(b)(1) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides that:

In the case of a corporation, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).

Taxable income means the corporation's taxable income as computed for federal income tax purposes. See IITA Section 203(e)(1). Net income of a corporation subject to tax by Illinois is the corporation's base income, as computed under IITA Section 203(b), to the extent apportioned to Illinois, minus the exemption and any net loss carryover to which the corporation is entitled. See IITA Section 202. Section 203(h) of the IITA provides:

Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

There is no provision in IITA Section 203 that can be read to allow or require adjustments to a corporation's federal taxable income to eliminate the effects of an election under Section 338 of the Internal Revenue Code to treat that corporation's sale of stock in a subsidiary corporation as a sale of the assets of the subsidiary, followed by a total liquidation of the subsidiary. Nor does the IITA require any adjustment to taxable income of the subsidiary. Accordingly, if a Section 338 election has been made, both the selling corporation and the subsidiary shall include in their base incomes the items of income or deduction included in their federal taxable incomes as the result of the election, and shall exclude from their base incomes any item of income or deduction excluded from the computation of their federal taxable incomes, unless modification to a specific item is required by Section 203.

Thus, although the IITA does not provide for recognition of a Section 338 election as such, the Illinois income tax consequences of the transfer of Unwanted Assets is determined by the Section 338 election. Gain or loss on the transfer itself will be recognized or excluded to the same extent as recognized or excluded in the computation of federal taxable income, and gain or loss on any subsequent sale or disposition of the Unwanted Assets, depreciation or amortization deductions allowed with respect to Unwanted Assets, and other items shall be the same as determined for federal income tax purposes.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

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Sincerely,

Paul S. Caselton  
Deputy General Counsel -- Income Tax